-- and thus the need for separation between their local exchange operations and their competitive services[36] -- and the same requirements should have no greater impact on the separation requirements applicable to LECs. Equal access requirements are substantially more difficult, if not impossible, to enforce in the absence of separation. Additionally, eliminating the separation requirement would increase the burden on the Commission of enforcing the equal access and non-discrimination requirements -- a result to be avoided under a deregulatory bill by an agency facing severe resource constraints.

The continuing need for separate affiliate requirements as a condition of non-dominant regulatory treatment for LEC interexchange services is underscored by the recent critical audits of BOC and LEC affiliate transactions conducted by state and federal authorities. For example, in April 1994, the Commission and the GTE Telephone Companies (GTOCs) entered into a Consent Decree settling issues arising out of an audit of the transactions between the GTOCs and two of their nonregulated affiliates. The audit revealed that the nonregulated affiliates achieved excessive rates of return

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[36] Compare Fifth Report, 98 FCC 2d at 1198, n.23 (need for separate BOC interexchange affiliate on account of BOCs' continuing local exchange bottleneck) with BOC Separation Decision, cited therein (Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Services by the Bell Operating Cos., 95 FCC 2d 1117, 1132-36 (1983)(prior order discussing implications of MFJ equal access requirements for BOCs), aff'd sub nom. Illinois Bell Tel. Co. v. FCC, 740 F.2d 465 (7th Cir. 1984)).

in their sales of services to the GTOCs and that the resulting excessive costs to the GTOCs were passed on to ratepayers. The terms of the Consent Decree required the GTOCs to file rate reductions, make a contribution to the United States Treasury and undertake other remedial actions.[37] Similar findings as to excessive nonregulated affiliate earnings have been made in audits of other carriers.[38]

Furthermore, the cost allocation and other accounting rules are only as good as the Commission's willingness and ability to enforce them with sufficient penalties to inhibit future misallocations. That final link in the chain may be the weakest of all. Most recently, the Commission released a summary of its audit of the BOCs' accounting for lobbying costs, which found $116.5 million in misclassified lobbying costs during the period from 1988 through 1991. Moreover, the inflated access rates resulting from such misclassifications were carried over into the LECs' access rates under price cap regulation.[39] In spite of these

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[37] Consent Decree Order, The GTE Telephone Operating Companies, AAD 94-35, FCC 94-15 (released April 8, 1994).

[38] See BellSouth Affiliate Transaction Audit: Summary of Audit Findings (undated); BellSouth Corporation, et al., AAD 93-127, FCC 93-487 (released Oct. 29, 1993); Southwestern Bell Telephone Co., AAD 95-32, FCC 95-31 (released March 3, 1995) (SWB Audit); Consent Decree Order, Ameritech, AAD 95-75, FCC 95-223 (released June 23, 1995) (Ameritech Consent Order).

[39] Commission Releases Summary of Lobbying Costs Audit Findings, Report No. CC 95-65 (released Oct. 26, 1995).

egregious violations, the Commission failed to take any remedial action for the past ratepayer injuries resulting from these misclassifications. Its failure to take such remedial action confirms the inadequacy of the entire cost accounting regulation and audit function, since the LECs apparently have a "free shot" at any accounting violation they may wish to commit, knowing that the worst that can happen is that someday, if they are caught, they might have to correct such practices only on a going-forward basis.

The cost misallocations, excessive costs and cross-subsidies uncovered by these audits, and the Commission's weak response thereto, thus demonstrate the ineffectiveness of the cost allocation regulations in preventing LEC cross-subsidies between regulated and unregulated services. Since LEC monopoly and regulated competitive services are more similar to one another than LEC regulated and unregulated services, allocations of costs between monopoly and competitive regulated services are even more difficult to audit. Thus, the cost allocation rules, having failed at their primary mission, certainly cannot be relied upon to prevent cross-subsidies between LEC monopoly and competitive interexchange services.

Moreover, price cap regulation has not dampened the incentive to misallocate costs, as shown by the continuation of such behavior under price cap regulation.[40] As explained above, price caps have not, and cannot, remove the incentives and ability to cross-subsidize, since LECs may choose to be subject to sharing each year, which generates incentives to shift costs. The failure of cost allocation and other accounting regulations and price caps to stem such behavior reinforces the need for a separate affiliate condition for non-dominant treatment for all LEC interexchange services.

C. BOC OUT-OF-REGION INTEREXCHANGE SERVICES SHOULD BE SUBJECT TO THE SEPARATE AFFILIATE REQUIREMENTS, DOMINANT CARRIER REGULATION AND THE OTHER SAFEGUARDS DISCUSSED IN MCI'S COMMENTS IN THE BOC OUT-OF-REGION PROCEEDING

Irrespective of the ultimate policy decision that is reached with respect to LEC out-of-region interexchange services, BOC out-of-region services should be subject to the separate affiliate requirements, dominant carrier regulation and the other safeguards discussed in MCI's Comments in the BOC Out-of-Region proceeding. Each Regional Bell Holding Company covers such a large contiguous territory and is so large in absolute size that the risk of undetected cross-subsidization and anti-competitive conduct and the potential scope of such conduct arising from the

[40] See, e.g., SWB Audit, supra, at ¶ 2(audit covered 1989 through 1992); Ameritech Consent Order, supra, Concurring Statement of Commissioner Andrew C. Barrett (audit covered transactions in 1992).

provision of interexchange services is much greater in the case of BOCs than in the case of the typical LEC.

Accordingly, MCI argued in its Comments in the BOC Out-of-Region proceeding that BOC out-of-region interexchange services should be subject to both mandatory separate affiliate requirements and dominant carrier regulation, as opposed to simply requiring a separate affiliate as a condition for non-dominant regulation, as in the case of LEC interexchange services. Since BOC out-of-region interexchange services need to be subject to more stringent requirements than LEC out-of-region interexchange services, any relaxation of the latter should have no influence on the Commission's ultimate decision as to the proper regime for BOC out-of-region interexchange services.

III. RATE AVERAGING AND INTEGRATION REQUIREMENTS OF THE ACT

Section 254(g) of the Act codifies long-standing Commission policies calling for "geographic rate-averaging" and "rate integration."[41] For the reasons explained herein, these requirements could pose a problem with regard to

[41] Specifically, the new law requires that the Commission, by August 8, 1996, "adopt rules to require that the rates charged ... in rural and high cost areas shall be no higher than the rates charged ... in urban areas." And, it requires further, that "[s]uch rules require ... [the provision of services] ... in each State at rates no higher than the rates charged to subscribers in any other State."

It is noted that this provision falls within the "Universal Service" section of the new law and, therefore, the principles set forth in Section 254(b) of the new law should lend a framework to evaluate the issues raised by these proposed requirements.

maintenance of an effectively competitive market, if they are perceived to be contradictory, which MCI does not believe to be the case. The basic objective of the rate-averaging requirement is to ensure that rates charged consumers in low-use and/or high-cost service areas are affordable, and the best way to achieve that goal is through competition, both in the interstate, interexhange and in local and exchange markets as well.

With the divestiture of the Bell System in 1984 and the subsequent development of substantial competition in interstate, interexchange services, the Commission has undertaken, at least implicitly, to try to balance the need of interexchange carriers to compete on price, on one hand, and to assure that rural subscribers share the benefits of competition by realizing fair and affordable pricing, on the other hand.

A characteristic of a competitive environment is that competitors are allowed to price at economic cost, with no arbitrary, artificial or extraneous factors influencing pricing decisions. This means that high-use and/or low-cost service areas should reflect lower prices for services than are charged in low-use and/or high-cost areas. Anything less is economically inefficient, and it would be impossible to conclude otherwise.[42]

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[42] MCI's rates for its standard service offerings are geographically averaged, such that a call between two locations of equal distance cost the same. This is the case even though,

A. GEOGRAPHIC RATE AVERAGING

In the NPRM, the Commission seeks comment on whether the geographic averaging requirement should apply to all providers of interstate, interexchange services.[43] It should, as there is nothing in the new law -- or equity or fairness, for that matter -- to support a finding that it ought only to apply to some telecommunications service providers.[44] Accordingly, the rule should apply to all existing and future interstate, interexchange carriers from the date of its enactment to the date of its repeal.

With regard to the question of whether the new law preempts state law, MCI does not believe that it does, unless state law is inconsistent with the federal standard

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independent of the costs MCI incurs to construct network facilities between locations, LEC access charges -- which constitute nearly half of the costs of providing IXC services -- vary. As an example, between July 1, 1994 and June 30, 1995, the per-minute terminating access charge to MCI for completing calls to a certain geographic locale was $.47 per minute, while MCI's highest tariffed per-minute rate at the time for an end-to-end call was $.33 per minute. Should MCI have been permitted to charge a higher rate to "cost-causing" customers calling into this high-cost area, as distinct from its other customers' effectively being obliged to subsidize those callers? Economic reality says "yes," of course; but the social and political goals reflected in the 1996 Act perhaps suggest otherwise. In any event, given that access costs essential to providing interstate, interexchange services vary among access providers, it could be argued, rationally, that any geographic rate-averaging obligation should be considered as "net of access," *i.e.*, exclusive of those essential costs over which IXCs have no direct control.

[43] NPRM at para. 67.

[44] Conceptually, however, the rule could be applied only to service providers who do not face effective competition, which would serve to achieve the policy objectives of the rule.

reflected in the new law and implementing Commission rule. The new law, cited by the Commission in Para. 68 of the NPRM, recognizes the authority of states over intrastate rates. Had Congress intended for the Commission to regulate intrastate interexchange rates, to the exclusion of the states, it would have more substantially amended the Communications Act, for example, Section 1 thereof, to extend Commission jurisdiction to more than "all interstate and foreign communication ...."[45] Accordingly, it appears, the Commission's proper and intended authority over intrastate rates is limited to its ability to provide "guidelines" to states and to preserve the federal approach if any state action is inconsistent therewith.

In addition, the Commission seeks comment on whether there may be "competitive conditions or other circumstances" that would warrant Commission forbearance from enforcing geographic rate averaging.[46] There are, of course, and the Commission so recognizes this when it indicates that "nationwide" interexchange carriers may be disadvantaged if they are required to compete against "regional" carriers, presumably those who enter the market to compete only in

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[45] 47 U.S.C. 152. Also, had Congress undertaken to repose in the Commission full authority over intrastate rates, it would be subject to the claim that it had exceeded its Constitutional authority under the Tenth Amendment.

[46] NPRM at para. 69.

select high-use/low-cost areas.[47] Theoretically, if geographic rate averaging were an absolute hard-and-fast rule, nationwide carriers could not compete effectively against less-than-nationwide carriers on the basis of price because their rates would be non-competitive.[48]

There have existed for several years now pricing programs for business customers based on volume and term discounts. MCI, for example, has entered into numerous "special customer arrangements," or contract-tariffs, with business customers willing and able to provide MCI with service volume and term commitments, in exchange for price concessions. And, in these instances, affected customer sites at which service is furnished at discount might just as easily be located in low-use and/or high-cost areas as in high-use and/or low-cost areas. Thus, these pricing plans, driven largely by the forces of economics and competition, are "geography-blind," and it would be foolish to contend

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[47] Id. at n. 154. Under well-established legal principles recognized by the Commission, disadvantaged carriers could respond by availing themselves of the "competitive necessity doctrine," which would allow them to respond in specific competitive encounters with offers matching those of their competitors.

[48] This is true, of course, even if the regional carrier were to honor a geographic rate averaging obligation throughout its service area. Its "averaged rates" likely would be lower because of the absence of low-use/high-cost factors characteristic of a nationwide approach.

that they have disadvantaged consumers in rural locations in any way.[49]

Additionally, MCI optional calling plans designed largely for residential customers -- which usually result in lower unit prices for service based on volume -- are equally free of the kind of price discrimination that the geographic rate averaging rule is intended to prevent. Thus, a "Friends & Family" customer located in a low-use and/or high-cost area will pay the same for MCI service as an identical customer will pay in a high-use and/or low-cost area, all other things being equal.

These marketplace approaches are not at all inconsistent with long-standing Commission policy on rate averaging which, it is clear, is not intended to be modified under the new law. Thus, there is a certain flexibility that allows for adherence to the rate averaging requirement, but which also accommodates the needs of competition. This delicate balance must be maintained. However, there clearly are circumstances, as recognized by the Commission, where strict and blind enforcement of the rate averaging rule would disserve the interests of competition -- and therefore consumers -- by not allowing nationwide carriers to compete on price. Thus, MCI submits, the Commission must interpret

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[49] The Congress appears to have concluded that these kinds of pricing plans for large customers are appropriate and, therefore, represent legitimate exceptions to the general policy reflected in the averaging rule. See Joint Explanatory Statement of the Committee of the Conference at p. 132.

the statute and any rule it enacts based thereon in a manner that accommodates both the thrust of the rule and the needs of competition.[50]

In view of the foregoing, so long as an interstate, interexchange carrier: (1) establishes standard service rates that are available to all similarly-situated customers throughout its service area; (2) implements contract-tariffs and optional calling plans (in reliance on those basic rates) that are available to all similarly-situated customers without regard to geography; and (3) is allowed to adjust its rates to address special competitive circumstances, such as competing against a carrier or carriers that do not operate on a nationwide basis, the tension -- indeed, potential serious conflict -- between the rate-averaging requirement and the desire for effective competition can be accommodated. Otherwise, the rate-averaging rule and the Nation's pro-competitive policy goals will be irreconcilable.

In order to assure that carriers comply with the rate averaging rule, the Commission is proposing that carriers

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[50] A case probably can be made that the geographic rate averaging requirement (and rate integration requirement as well) should apply only to residential subscribers. Congress placed the goal of rate parity for services in the Universal Service section of the new law, implicitly recognizing that rate parity provisions may involve subsidies to subscribers in low-use and/or high-cost areas. (See Joint Explanatory Statement of the Committee of Conference at 131.) Consequently, if the Commission were to limit the rate parity requirement to residential subscribers, it would minimize subsidy flows and, in so doing, relieve the market distortions that result from rate averaging and integration.

"file certifications" with the Commission "stating that they are in compliance with" their obligations.[51] Because the Commission has tentatively decided to exercise its forbearance authority to require detariffing -- a matter to be addressed, as noted above, in "Phase 2" of this proceeding -- it could no longer rely on tariffs as a monitoring or enforcement mechanism, as it has in the past, to assure geographic rate averaging.[52] It thus is proposing, apparently without more, that carriers simply commit in writing that they are complying with the rule. MCI has no problem with this so long as it is readily understood what the commitment entails -- and what it does not entail. As explained in detail above, what appears to MCI to be full satisfaction of the rate averaging obligation (while reasonably accommodating the needs of competition) may not be consistent with another's reading of that obligation and, accordingly, the prospect of litigation arises.[53]

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[51] NPRM at para. 70.

[52] MCI plans to oppose mandatory detariffing as proposed in the NPRM on the ground that the Commission cannot satisfy the statutory criteria essential to its lawful ordering of forbearance of the Section 203 tariffing obligation.

[53] The Commission specifically looks toward Section 208 complaints as the means by which "violations" of the rate averaging obligation could be brought to its attention, presumably to be remedied after the completion of a complaint proceeding. This, it would appear, would place a significant burden on Commission staff who have experienced difficulties in recent years in timely disposing of formal complaints brought before it.

Were the Commission to require or permit tariffing to continue, tariffs would serve as an adequate mechanism to assure that carriers satisfy the rate averaging requirement. This is because Section 203 requires that rates be filed and made effective prior to their application and, therefore, the Commission would possess adequate insight into the rates being charged. It could then determine rule compliance and, in the process, take any action necessary against non-complying carriers.[54] As noted above, however, MCI's optional calling plans -- which likely would survive any detariffing requirement -- are not geographically restricted and all similarly-situated customers, business or residential, are eligible to subscribe to those plans.

With regard to the question of whether carrier "promotions" sometimes are geographically limited, the answer is that they are, usually because of a carrier's desire to promote its offerings on a "market trial" basis or more intensely in a particular area for cost or other competitive reasons. Promotions have been a favorite of the Commission, and it has allowed them to take place even when tariffs offering them have been challenged on Section 202(a)

[54] The Commission appears to suggest (para. 71) that the one-day tariff-filing requirement applicable to non-dominant carrier tariffs hinders its ability to monitor the rate-averaging practices of interstate carriers, even with tariffs. The short answer here is that the Commission's authority in connection with carrier tariffs is by no means restricted to actions taken <u>before</u> the tariffs take effect. Indeed, the Commission is amply empowered to take action against carrier tariffs <u>after</u> they have taken effect. <u>See</u> Sections 205, 402 and 4(i) of the Act.

and 201(b) grounds, including contentions that geographically-restricted promotions -- whether by NPA or state -- violated the Commission's rate-averaging policy. A primary reason for the Commission's upholding the lawfulness of these promotions appears to be that they are only "temporary" in duration and usually involve the conferring of some nominal economic benefit on recipients, and that any resulting discrimination, price or geographic, is not sufficiently significant in impact to warrant regulatory action.[55]

To answer, then, the question posed by the Commission,[56] promotional plans that are made available in less than a carrier's full service area arguably constitute geographic rate deaveraging. There simply can be no other answer here, of course. The more important question is whether such pricing actions are so egregious in nature and effect as to undermine the Commission's overall rate-averaging policy and rule. MCI, as, apparently, the Commission historically, does not believe that to be the case at all. Indeed, the effect of a requirement that promotions be made available, if at all, only throughout a carrier's <u>entire</u> service area would likely cause the carrier

[55] Apart from their perceived pro-competitive impact, the Commission believes that promotions result in increased use of carrier networks, with resulting increased productivity that is recaptured following Price Cap performance reviews.

[56] NPRM at para. 72.

to cease implementing promotions or, at least, as many of them.

Finally, the Commission asks whether AT&T, recently found non-dominant in the domestic interstate, interexchange market, should continue to be bound to commitments that it previously made to achieve such regulatory status.[57] MCI agrees with the Commission's tentative conclusion that AT&T should not be so bound to any commitments other than those that may arise from this proceeding and apply equally to all non-dominant carriers.

B. RATE INTEGRATION

As noted above, the 1996 Act also requires adoption of a rule that requires carriers to provide their services in each state at rates no higher than the rates charged to subscribers in other states. This requirement, referred to as "rate integration," has long been Commission policy and has involved the forty-eight contiguous states and various non-contiguous United States locations, including Alaska, Hawaii, Puerto Rico and the U.S. Virgin Islands.

The original rationale for the requirement was that satellite technology resulted in distance being less of a factor in the cost of providing service. Thus, the Commission's rate integration policy required that rates for

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[57] Id. at para. 73.

service between various points are equivalent to those prevailing for comparable distances.

Carriers, of course, should be allowed to consider distance when setting rates because carrier networks today are comprised of much more than satellite technology. Microwave, fiber and cable constitute the lion's share of most carriers' networks and these technologies clearly result in costs that are distance-related. Carriers should also be allowed to consider differences in terrain when setting their rates. For example, the "wetlink" distance involved in a call will affect the cost of providing services.

Any pricing rule that did not allow for such differences potentially would be anti-competitive in effect. If, for example, a call between New York City and Guam[58] could be charged at no more than a call between the two most distant locations covered under the current rate integration policy, then callers along a carrier's other routes would be subsidizing the Guam callers because of the longer physical distance -- and higher costs -- between most U.S. locations and Guam. This clearly has anti-competitive implications for the simple reason that competitors would be deprived of an ability to price at true cost (although it appears that they would be able to satisfy the rate integration rule by

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[58] The new law extends the rate integration requirement for the first time to Guam. (NPRM at para. 77).

establishing a new, expanded "rate band" to accommodate the greater distance and resulting higher costs involved in serving Guam from most locations in the States).[59]

All this is not to say that those calling to or from Guam (or any other points covered by the rule) should not have the ability to acquire service at affordable rates, because they should. Those service rates, however, need to reflect true economic costs as perhaps tempered by competitive influences in the marketplace.

With regard to questions concerning how, in the absence of tariffs, the Commission could enforce the rate integration rule, and whether AT&T ought to be held to prior commitments that it made in order to achieve non-dominant status,[60] MCI's responses are as set forth above, in connection with the rate averaging issue. The more effective enforcement mechanism to assure conformance with a rate integration rule would be tariffing, which MCI believes should remain an available alternative for non-dominant carriers. Certification, as proposed, would not be inappropriate, except that no enforcement would likely occur in the absence of an adjudicated complaint, and these could

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[59] In addition, as discussed above in connection with geographic rate averaging, carriers also should be permitted to consider the effects of competition, including the presence of regional carriers, in establishing their service rates.

[60] NPRM at paras. 78-79.

take several years, given the Commission's "track record" in complaint-handling.

Finally, MCI agrees that AT&T should not be required to honor commitments previously made in connection with its efforts to achieve non-dominant status and, therefore, it should be subject to the same rules as other non-dominant carriers.

CONCLUSION

The Commission should take into account the above comments in addressing and deciding the important issues raised in this proceeding.

Respectfully submitted,

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Dated: April 19, 1996

MCI'S OPPOSITION TO SOUTHWESTERN BELL'S REQUEST FOR A WAIVER TO PROVIDE INTEREXCHANGE SERVICE

TO: THE DEPARTMENT OF JUSTICE

MCI Communications Corporation ("MCI") opposes the request of Southwestern Bell Corporation ("SWB") for a waiver to provide certain interexchange services. Memorandum of Southwestern Bell Corporation in Support of Its Motion for an Expedited Waiver of the Modification of Final Judgment to Exempt Out-of-Region Telecommunications Services from the Interexchange Restriction of Section II (submitted to DOJ July 11, 1994) ("SWB Mem.") (Waiver No. W0202).

1. *Consolidated Consideration.* Southwestern Bell's request raises issues closely related to other pending petitions submitted by Bell Operating Companies ("BOCs"). For example, SWB joined three other BOCs in moving to vacate the decree, and grant of that motion would moot this request. Earlier this year, Bell Atlantic requested a similar, but narrower, generic waiver to provide interexchange services outside its region. Bell Atlantic's Request for an Expedited Waiver Relating to Out-of-Region Interexchange Services and Satellite Programming Transport (submitted to DOJ Jan. 20, 1994) ("BA Request"). As MCI explained in its July 28, 1994, submission to the Court concerning procedures for the motion to vacate, the Department and the Court should consider all of the interrelated pending requests on a coordinated basis.

SWB has certainly not demonstrated any justification for "expedited" treatment of its request. SWB argues that expedited treatment is appropriate because out-of-region services pose no conceivable possibility of competitive abuse. SWB Motion at 2. However, as explained below, the Court has repeatedly rejected precisely this contention, and in any event, SWB proposes to provide interexchange services *inside* as well as outside the region in which it provides local exchange service.

2. *Continuing Dangers of Bottleneck Abuse.* If any summary action were appropriate, it would be to deny, not grant, the request. In decisions ignored by SWB, the Court has consistently rejected petitions by the BOCs to provide interexchange services outside the territories where they control local exchange bottlenecks. *United States v. Western Elec. Co.*, 1989-1 Trade Cas. (CCH) ¶ 68,619 (D.D.C. June 13, 1989); *United States v. Western Elec. Co.*, 673 F. Supp. 525, 543-44 (D.D.C. 1987), *aff'd in relevant part*, 900 F.2d 283, 300-01 (D.C. Cir.), *cert. denied*, 498 U.S. 911 (1990). The result should be no different here. In responding to a related request by Bell Atlantic, MCI previously explained why the BOCs should not be permitted to provide interexchange services outside the territory in which they provide local exchange service. *See* letter to Richard L. Rosen from Anthony C. Epstein, at 2-8 (dated March 8, 1994) (Wavier No. W0195).

Most importantly, SWB's proposal fails to come to grips with the fact that, even if SWB were to provide inter-LATA services only outside its region, it would be competing directly against other interexchange carriers in the single, nationwide interexchange market. It remains "[t]he plain and universally recognized fact . . . that the market for inter-exchange services is national." *United States v. Western Elec. Co.*, 673 F. Supp. at 543.[1] In its pending request for a broad interexchange waiver, Ameritech confirmed that "today's interexchange business . . . still extends across the nation." Memorandum in Support of Ameritech's Motions to Remove the Decree's Interexchange Restriction, at 9 (submitted to DOJ Dec. 7, 1993) (Waiver No. M0023).

By this waiver, SWB seeks to enter the national interexchange market and to provide both originating and terminating services in over 90 percent of this market (the territories of the other BOCs and independent local exchange carriers), and terminating services in the remainder (its own territory). This petition therefore presents "the principal problem to which section II(D)(1) of the decree is addressed: *the threat of competition by the Regional Companies themselves in the interexchange business.*" *United States v. Western Elec. Co.*, 627 F. Supp. 1090, 1100 (D.D.C.) (emphasis in original), *appeal dism'd*, 797 F.2d 1082 (D.C. Cir. 1986).

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[1] *See* Response of the United States to Comments on Its Report and Recommendations Concerning the Line-of-Business Restrictions Imposed on the Bell Operating Companies by the Modification of Final Judgment, at 40-41 (filed April 27, 1987) ("1987 DOJ Response").

Interexchange carriers remain dependent on SWB for exchange access in states where SWB retains its local bottleneck. "A Regional Company that competes against such providers everywhere except in its own region would not find it difficult to discriminate against such a provider in its region, thereby damaging the competitor's service and reputation on a national basis." 1989-1 Trade Cas. at 61,266.[2]

This danger is addressed only in the Affidavit of Alfred E. Kahn and William E. Taylor, at 15-16 (Ex. 4 to SWB Mem.) ("Kahn/Taylor Aff."). Although Kahn and Taylor dismiss this risk as speculative or remote or indirect, their reasons do not stand up. Their principal argument is that SWB would not want to jeopardize in-region revenues and profits from access charges. However, SWB would not expect such discrimination to reduce interexchange traffic originating in its region. Kahn and Taylor acknowledge that SWB retains its local monopoly, Kahn/Taylor Aff. 7 ¶ 17 (local exchange carriers "now dominate the provision of telephone service"); see Affidavit of Gary S. Becker, at 7 (Ex. 1 to SWB Mem.), so customers in SWB's territory who want to make interexchange calls have no alternative but to continue to use the inter-

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[2] SWB's ability significantly to increase its rivals' costs exists even if SWB controls less than ten percent of local exchange service and even if less than five percent of interexchange traffic originates outside and terminates inside SWB's territory. SWB Mem. 3-4. Nor would structural separation of SWB's interexchange affiliate (SWB Mem. 20) do anything to reduce the dangers of discrimination. *See* Response of the United States to Public Comments on Proposed Modification of Final Judgment, 47 Fed. Reg. 23320, 23336-37 (May 27, 1982).

exchange carriers victimized by discrimination, leaving SWB's access charge revenues undiminished.[3] Although they dismiss the benefits of in-region discrimination as "clearly . . . highly remote and indirect" (*id.*), they offer no explanation or support for this conclusory assertion. Kahn and Taylor also suggest that the risk of enforcement of anti-discrimination rules will deter this conduct, Kahn/Taylor Aff. 15-16, but because such rules do not provide effective protection against discrimination, the prophylactic decree embodied a structural approach. Letter to Richard L. Rosen from Anthony C. Epstein, at 27-28 (dated Feb. 7, 1994) (Waiver No. M0023).

3. *Provision of Terminating Service*. SWB's petition is misleading -- and broader than Bell Atlantic's -- because contrary to its label, SWB seeks authority to provide *in-region* as well as out-of-region interexchange service. SWB proposes to provide terminating services within its region for calls originated outside its region. SWB Mem. 16. In contrast, Bell Atlantic expressly disclaimed any desire to provide terminating services within its region, and it pro-

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[3] In their affidavit for Bell Atlantic, Kahn and Taylor suggested that the incentive to discriminate against interexchange carriers already exists in-region because Bell Atlantic competes with these carriers in providing intraLATA toll services. Exhibit 1, at 14-15, to BA Request. Without any explanation, they drop this argument from their affidavit for SWB. In any event, discrimination in dialing arrangements and access charges for intraLATA toll services has been more than sufficient to enable the BOCs to retain their dominant share of these services. *See* Letter to Richard L. Rosen from Anthony C. Epstein, at 45-46 (dated Feb. 7, 1994) (Waiver No. M0023).

posed that calls originated out-of-region would be terminated in-region by an unaffiliated interexchange carrier selected on a nondiscriminatory basis, by the customer or otherwise. BA Request 31, 35 & n.86.

Provision of terminating services provides significant opportunities for bottleneck abuse. SWB focuses on discrimination on a call-by-call basis, SWB Mem. 16-19, and ignores discrimination involving entire types of services and interconnections. For example, the interface between the interexchange carrier and the local exchange carrier at the terminating end of the call is becoming increasingly sophisticated, particularly with respect to signaling information (for example, passing the number of the calling party for Caller ID services).[6] As a result, BOCs have the ability to discriminate in favor of their long-distance operations in providing new interfaces at the terminating end. SWB's proposal would also apparently permit it to provide 800 service where the calls terminate within its region. This traffic is concentrated at terminating end, giving SWB substantial opportunity to discriminate in-region in favor of its 800 service customers, and against customers of competing interexchange carriers, in filling orders for circuits and providing adequate maintenance and customer support. Similar

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[6] Competitive dangers at the terminating end have long existed. For years before divestiture, MCI sought from the BOCs equal treatment with AT&T in obtaining answer supervision (information whether the called party answered the telephone), and the BOCs delayed providing it to MCI, forcing MCI to rely on costly and less efficient substitutes.

opportunities exist in connection with other interexchange services where traffic is concentrated at the terminating end -- for example, inbound calls to information service providers.

SWB's proposal to use leased rather than owned facilities inside its region to terminate calls does not eliminate any substantial possibility of competitive abuse. The Court has long held that the judgment's prohibition against BOC provision of interexchange services applies equally to resale and facilities-based services because both involve direct competition with legitimate interexchange carriers. *United States v. Western Elec. Co.*, 627 F. Supp. at 1100-01; *see United States v. Western Elec. Co*, 907 F.2d 160, 163 (D.C. Cir. 1990) ("The critical distinction under the decree is not whether the BOC owns the interexchange capacity, but whether it 'provide[s]' interexchange service to its customers").

4. *Continuing Practical Difficulties.* Contrary to SWB's contention (SWB Mem. 16), there has been no change in the "practical difficulties" that the Department cited when it abandoned its erstwhile proposal to permit BOCs to provide interexchange services that neither originate nor terminate in their regions -- difficulties that would only be exacerbated if SWB were allowed to provide terminating services within its region. It remains true that "BOC evasion of an in-region limitation could pose a substantial risk to a major decree objective -- development of effective